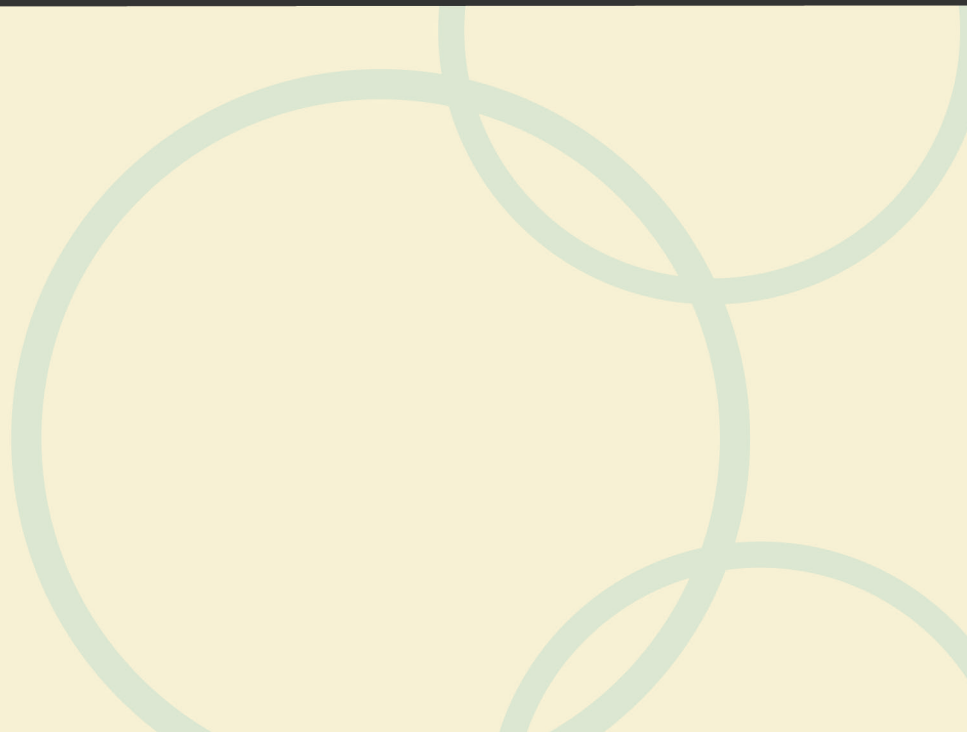


2017

ANNUAL REVIEW



The Independent Directors Council (IDC) supports fund independent directors in fulfilling their responsibilities to promote and protect the interests of fund shareholders. Through its mission of advancing the education, communication, and policy positions of independent directors—and promoting public understanding of their role—IDC advocates for high standards of fund governance, for the benefit of funds and their shareholders. IDC also provides practical information and guidance to fund boards about important issues, helping them adapt to regulatory and industry developments.

IDC is part of the Investment Company Institute (ICI), the leading association representing regulated funds globally, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide.

In the United States,



oversee more than



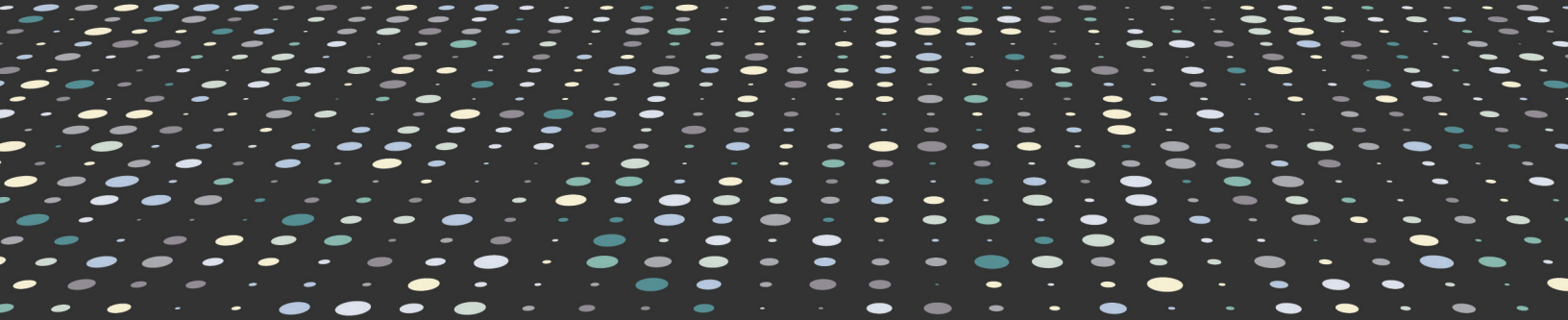
with more than



and represent the interests of more than



** Data exclude unit investment trusts. Data for mutual funds and exchange-traded funds are as of November 2017. Data for closed-end funds are as of September 2017.*



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Letter from the Governing Council Chair



JONATHAN F. ZESCHIN

Ask a group of fund directors about the position, and their steadfast commitment to protecting shareholder interests will likely lead the conversation—though the ever-changing nature of their work won't be too far behind.

The fund industry's tremendous growth and evolution in recent years explains a good bit of this change. But the many board responsibilities established in Securities and Exchange Commission (SEC) rules and other initiatives have had an even greater impact.

In 2017, many of these responsibilities remained outdated, impractical, or at odds with directors' conventional oversight role. And new leadership at the SEC, including in the Division of Investment Management (IM), presented a prime opportunity to pursue a long-overdue update.

With the support of independent directors and board counsel, IDC took up that pursuit in October, delivering a thorough, 18-page letter to the new IM director. The letter asked for a comprehensive review of the responsibilities imposed on fund boards, and outlined ideas for how best to modernize them. The task ahead is to explore these ideas more fully with SEC staff, with the goal of developing practical solutions that satisfy regulatory interests while enabling directors to be even more efficient and effective.

A focus of this effort will be to relieve boards of responsibilities that have become ritualistic or duplicative, or are more appropriate for other fund personnel or service providers. The main objectives are to update the regulations requiring boards to perform tasks that chief compliance officers already handle, and to move responsibilities for making technical determinations from boards to the specialists with the requisite training and skill sets. Doing so will free up boards to focus on the areas where they add the most value.

With this modernization effort, our long-term goal is to ensure that all board responsibilities fit within an oversight—rather than a management—role, that they task directors primarily with overseeing potential conflicts of interest, and that they strengthen boards' ability to serve fund shareholders. This goal applies not only to responsibilities on the books today, but to those that the SEC might consider in future rulemakings.

To that end, we were pleased to hear in December that SEC staff has begun work on a new project—the Board Outreach Initiative—aimed at reviewing and reevaluating what the Commission asks boards to do, with an eye toward whether funds could benefit from a recalibration of directors' duties. We look forward to engaging with the staff as work on this project progresses.

Opportunities for meaningful reform of board responsibilities don't come along too often, so we'll be doing everything we can in 2018 to make this one count. Fund directors—and the more than 100 million shareholders they serve—deserve nothing less.

A handwritten signature in black ink, appearing to read "JF Zeschin". The signature is fluid and cursive, with a long horizontal stroke at the end.

Letter from the Managing Director



AMY B. R. LANCELOTTA

If there has been a single constant across IDC's 13-year history, it's the stability of our four-part mission. Every year, we strive to educate fund independent directors, bring them together for meaningful dialogue, voice their perspective in policy debates, and promote public understanding of the important role they play in the regulated fund industry.

Yet the ways we carry out that mission are always evolving. Whenever we consider a new initiative—or look to build on our past successes—we take stock of industry trends, survey the regulatory environment, and incorporate the ideas of the fund director community, so that we can tailor our work to directors' changing needs.

Our efforts to educate directors in 2017 centered on our new *Foundations for Fund Directors* orientation program. *Foundations*, which we designed to help newer directors bolster their core skills and succeed in their role, debuted late last summer with an online course and in-person training in Boston (see page 4).

We also held our annual Fund Directors Workshop and Fund Directors Conference, where directors gathered with industry leaders, operations professionals, board counsel, and others for discussion on the hot-button issues facing fund boards today—and for the unparalleled networking opportunities that have long set these conferences apart as the fund director community's premier events.

In addition, we hosted seven new webinars, helping directors navigate an array of complex regulatory issues; 16 regional chapter meetings, facilitating discussions among directors on governance practices and approaches to handling new regulatory responsibilities; and eight industry segment conference calls, enabling directors to participate in dialogue tailored to their specific board roles. We thank everyone who joined us for our events in 2017, and hope you'll join us again in 2018.

On the advocacy front, we wrote to the new director of the SEC's Division of Investment Management (IM), Dalia Blass, asking her to take a fresh look at all the board responsibilities that have accumulated over the years. We believe that such a review should aim to modernize these responsibilities to strengthen directors' ability to serve fund shareholders. IM's new initiative to review and reevaluate directors' responsibilities, announced in December, looks to be a big step toward that goal.

Our work in this area will ramp up in 2018—but that will be far from the only item on our agenda. Thanks to the efforts of our talented staff and Governing Council, we'll be working on a range of projects to support fund directors in their important work on behalf of fund shareholders.

Indeed, more than 100 million shareholders depend on directors' robust oversight to protect their interests. At IDC, we believe that directors are best equipped to supply that oversight when they can continually develop their knowledge and skills, exchange ideas with their peers on other boards, and operate in a regulatory environment that recognizes their conventional oversight role. We look forward to further strengthening our commitment to these principles in 2018.

A handwritten signature in black ink that reads "Amy Lancellotta". The signature is written in a cursive, flowing style.

The *Foundations for Fund Directors* Orientation Program

When IDC began developing ideas for a director orientation program, it did so with a simple principle in mind: every new fund director should be an engaged and active contributor to the board as soon as possible.

The program that emerged from this principle—*Foundations for Fund Directors*—has become one

of IDC's strongest education initiatives. Designed in consultation with top fund industry and fund governance experts, the unique and innovative program helps newer directors quickly build their knowledge and skills, walks them through the nuances of their complex responsibilities, and prepares them to succeed in their oversight role.

DIRECTORS LEARN ON THEIR OWN—AND WITH THEIR PEERS

Created for directors with up to three years' experience, *Foundations for Fund Directors* comprises both an online course and in-person training:

- » The online course, divided into four modules, introduces directors to their core responsibilities—and prepares them for the in-person training.
- » The in-person training builds on the online course, with two days of interactive, hands-on learning through case studies and group discussion, led by fund directors with decades of experience.

The program also includes supplemental videos providing detailed walk-throughs of important topics that directors need to understand, such as governance practices, how funds are taxed, proxy voting of portfolio securities, and Section 36(b) of the Investment Company Act of 1940.

TWO SESSIONS STILL AHEAD IN 2018

- » **April 11–12** (CHICAGO)
- » **September 12–13** (NEW YORK)

Keep an eye on www.idc.org/foundations for more details and registration information!

If you have questions, please contact IDC's Conferences team at 202-326-5968 or conferences@ici.org.



EVERYTHING DIRECTORS NEED TO KNOW— AND NEED TO KNOW HOW TO DO

Participants in *Foundations for Fund Directors* develop broad knowledge and a wide variety of skills—all integral to protecting shareholder interests.

Fund fundamentals

- » How registered funds operate and how they are regulated
- » The role of registered funds in the economy and financial markets

Guiding principles

- » How to ensure and maintain independence
- » How to fulfill the fiduciary duties of loyalty and care
- » How to oversee potential conflicts of interest
- » How to use shareholder interests as a guide in fulfilling oversight responsibilities

Core responsibilities

The 15(c) process

- » How to handle the process for reviewing a fund's advisory contract
- » How to apply the *Gartenberg* factors when deciding whether to approve a fund's advisory contract

Investment management and performance

- » Factors to consider when evaluating a fund's performance

Fair valuation

- » Responsibilities in determining the fair value of portfolio investments
- » Common practices for overseeing the fair valuation process

Liquidity

- » Fund liquidity requirements
- » Board responsibilities under the SEC's new liquidity risk management rule

Distribution

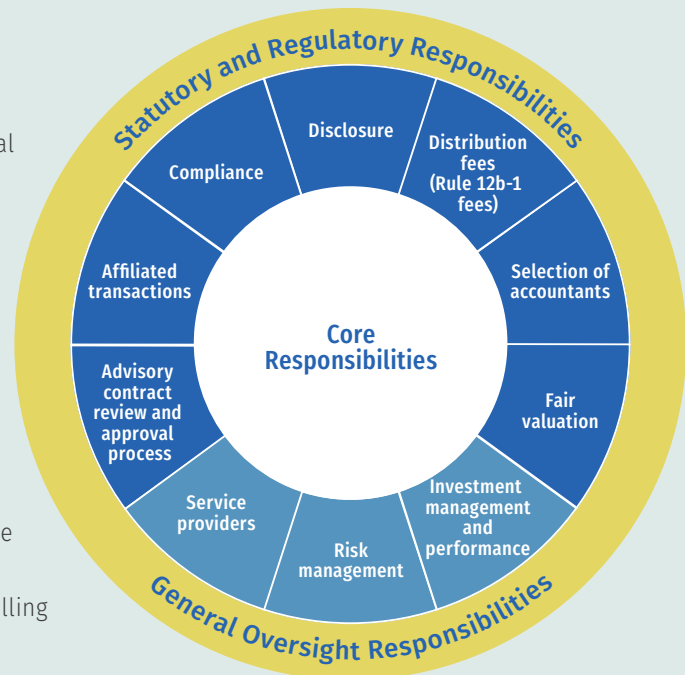
- » Responsibilities under Rule 12b-1, the rule governing the use of fund assets to pay for distribution
- » The process for reviewing and approving the fund's contract with its principal underwriter

Compliance

- » The elements of a culture of compliance
- » Oversight responsibilities under the fund compliance program rule
- » The board's relationship with the fund's chief compliance officer

Risk management

- » The value of risk management in the fund industry
- » Types of investment risks to focus on when overseeing risk management
- » Ways to determine an appropriate level of board involvement



The Director Perspective: A Conversation with IDC Committee Chairs

On the sidelines of the 2017 Fund Directors Conference, three members of IDC's Governing Council sat down for a conversation about their service as chairs of the Governing Council's operating committees and as fund independent directors.

» **Joanne Pace**

Independent Director, OppenheimerFunds
Chair, IDC Education and Communications Committee

» **Steven Paggioli**

Independent Director, AMG Funds and Professionally
Managed Portfolios
Chair, IDC Policy Steering Committee

» **Dawn Vroegop**

Independent Director, Brighthouse Funds and
Driehaus Funds
Chair, IDC Governance Committee

How does the committee you chair support IDC's mission?

Paggioli: Our principal focus on the Policy Steering Committee is to act as a voice for directors in policy and regulatory debates that could affect them or their work on behalf of fund shareholders. Over the past 10 years or so, the SEC [Securities and Exchange Commission] has issued several proposals imposing new responsibilities on fund boards, so we've had quite a bit to respond to. Where we've believed that the proposed responsibilities haven't fit with directors' oversight role as outlined in the Investment Company Act of 1940, we've advocated vigorously for revisions.

...

*Our industry is always evolving,
so we do our best to ensure that our
education and communication initiatives
evolve right along with it.*

JOANNE PACE

...

But with the recent changes in SEC leadership, we haven't yet had as many proposals staring us in the face. That has enabled us to focus more on the long-overdue task of modernizing the many board responsibilities that have become obsolete, duplicative, or counterproductive. We outlined our recommendations in a detailed letter to the new director of the SEC's Division of Investment Management in October, and will continue to pursue this effort throughout the year ahead.

Pace: The goal of the Education and Communications Committee is to create opportunities for directors to learn—from resources we provide, as well as from each other—so that they can better serve shareholders. Conferences, webinars, conference calls, chapter meetings, IDC's website—if it involves educating or communicating with directors, it falls to us.

Our industry is always evolving, so we do our best to ensure that our education and communication initiatives evolve right along with it. This means more than keeping up with industry trends—though that's certainly important. It means engaging with directors, finding out what's on their minds, and incorporating their input into our new programs. The key thing is to stay relevant to the fund director community.

Vroegop: On the Governance Committee, we work to bring exceptional directors onto IDC’s Governing Council, which plays a major role in advancing IDC’s mission. The goal here is to build a “fund director mosaic”—meaning a Governing Council that represents all facets of the fund director community. For example, we look for directors from boards of varying sizes, directors from fund complexes active in a wide range of investment products, and directors who bring many different skills and experiences to the table.

It sounds as if you’re saying that a diverse Governing Council makes a strong Governing Council. But what about the composition of boards themselves—in your view, does a board’s composition affect its performance?

Vroegop: Absolutely. Research shows that a board’s diversity is critical to its success. On the board where I serve, we consider a range of diversity metrics—not just in race and gender, but also in age, geography, skills, and experience. Before we begin the process of nominating new directors, we first look at our board and perform a skills assessment—to see where we have strengths and where we might have needs. This analytical approach has proven to be quite valuable in building a strong board.

Pace: We take a similar matrix-like approach, and think of it as a search for the right mix of culture, personality, skills, and experience. I’ll also say, having professional experience outside asset management is useful, as is having directors who can think beyond their own expertise and experience—whatever they might be—and see the big picture.

• • •
*Good directors know when to dig in,
and when to step back and let
management do its job.*

STEVEN PAGGIOLI

• • •



FROM LEFT: DAWN VROEGOP, JOANNE PACE, AND STEVEN PAGGIOLI

Paggioli: Right—specialized expertise isn’t the whole ball game. If boards do recruit directors with specialized expertise, they must take care to ensure that their prospect also has the mindset to take a big-picture view when needed. It can be easy for directors with highly specialized skill sets to zero in on the areas they’re most familiar with—and have less of a focus on the rest of their boards’ agendas.

What qualities do you each think are the most important for a fund director to have?

Pace: For me, the most important quality has to be demonstrated good judgment and leadership in their previous professional experience. A close second would be an ability to ask the right questions, which is key to an oversight role.

Paggioli: I wholeheartedly agree about the good judgment and leadership. I’d also point out that, at least for me, a prospective director’s previous experience need not be at a financial services enterprise, even though that’s very often helpful. And though it might sound a bit basic, understanding the difference between management and oversight is also key. Good directors know when to dig in, and when to step back and let management do its job—you know, what the fund is paying for under the terms of its advisory contract.

CONTINUED ON NEXT PAGE

In looking for new directors, it's important to seek people who have the time to devote to a robust agenda year in and year out, which might not be easy if you're still working full-time. It's also important to look for people who are eager to become knowledgeable about the industry—beyond a layman's understanding—if they haven't already worked in it.

What advice would you offer to new directors?

Paggioli: New directors—actually, experienced directors too—should look beyond the materials they get from management. Even if it's not at a detailed level, keeping an eye on the news affecting funds and financial services more broadly can be helpful in understanding the context of your considerations.

Pace: Having a mentor on the board to help with the transition from serving in a management role during your career to serving in an oversight role as a director can also be very useful. So can establishing a peer network, to talk through any questions you might have. Do you hear all those voices out there [during a conference reception]? That's the sound of connections being made!

Vroegop: Yes, there are real benefits to having a mentor on the board. I'd also suggest that new directors work with their mentor—and the fund adviser—to develop an onboarding plan, with the goal of gaining an understanding of how the adviser runs its business. If formal onboarding with the adviser isn't possible, spending time with key management personnel can help new directors gain that understanding.

Let's talk more about the board's working relationship with the adviser. What do each of you think is the most important element of a strong board-adviser relationship?

Pace: I'd say it's a mutual respect and recognition that the board and adviser, although they have different roles, both have a fiduciary responsibility to fund shareholders. When we're direct with each other about conflicts, issues, and concerns, we foster a healthy dialogue.

• • •
*The more information boards have,
the better they can protect
shareholder interests.*

DAWN VROEGOP

• • •

Vroegop: Right. I'd add that, as a director, one of the best things you can do is avoid anything that could even give the appearance of trying to encroach on the adviser's territory—that's an easy way to undermine the relationship. But to do your job effectively, you do need to make sure that you're being adequately informed by the adviser on important matters, such as significant personnel changes, plans for new funds, and cyber events. The more information we have, the better we can protect shareholder interests.

Paggioli: For me, one of the most important elements is cultivating a "no surprises" working environment. Yes, there will always be unexpected events, but the atmosphere and the relationship should be such that no one's shocked when something new or different is proposed.

How do boards cultivate that environment?

Paggioli: Some boards hold a strategy session with management away from the regular agenda—every year, and sometimes more often than that. Let's say it's a year-end session. Boards might ask management: What's your industry outlook for next year? Where do you see the fund complex going? Do you have any new products in the pipeline—and, if so, what are they? Do you anticipate any distribution challenges in the coming months?

Sessions like these keep management and the board on the same page, and make our jobs as directors a whole lot easier. When we're prepared for what's coming on the next three or four quarterly agendas, we can think about questions and concerns far in advance of having to vote on something—which helps us make better decisions on behalf of shareholders.

Vroegop: And aside from those discussions, boards today are having more pre-meeting phone calls and other opportunities to talk with management outside the boardroom than they once did. Independent directors' role in setting the board agenda is much larger than it was 10 or 20 years ago—it has evolved over the years, just as governance practices have.

IDC and ICI survey the boards of fund complexes on these governance practices through their *Directors Practices Study*, and share the results with the participating complexes. How does your board use the study?

Pace: Our board uses the study regularly, and we find its depiction of trends to be especially useful. The trends enable us to see where we stand in comparison with other boards on a range of governance practices—and how that has changed over time, if it has. The fact that you can drill down and compare your board with those of other similarly sized fund complexes—on all sorts of practices—is also very helpful.

Paggioli: One thing that one of my boards does—and I think this is one of the most useful features of the survey—is get custom reports with the data broken down by the specialized peer group that we choose, on the survey question that we choose. In this way, the survey is very participant-friendly. It's a credit to IDC for providing this service.

Vroegop: I have to say, the study is a great read from cover to cover—every page is informative. We also use it to gauge where we stand in comparison with other boards. But it's more than that—it informs the self-assessment that our board conducts each year, and it often starts a discussion on how we might operate going forward.



For example, if we're in the minority on a particular governance practice, we might ask ourselves questions like, "Should we be making any adjustments?" or "Does this pertain to us?"—things like that. Still, we're careful not to change something just because we're doing it differently from how other boards might do it. If we're in the minority on something, we usually have a good reason. I think most directors would agree that there's really no right answer on governance practices. Every board is unique.

Governing Council Members (AS OF JANUARY 1, 2018)

Jonathan F. Zeschin, Chair*

Matthews Asia Funds

Dawn M. Vroegop, Vice Chair*

Brighthouse Funds and Driehaus Funds

Julie Allecta

Salient Funds

Kathleen T. Barr

William Blair Funds

Donald C. Burke

Duff & Phelps Funds and Virtus Funds

Gale K. Caruso

Matthews Asia Funds and Pacific Life Funds

David H. Chow

MainStay Funds and Market Vectors ETF Trust

Susan C. Coté

SEI Funds

Bruce Duncan*

T. Rowe Price Funds

William R. Ebsworth

Wells Fargo Funds

Paul K. Freeman*

Deutsche Funds

Susan C. Gause

Brighthouse Funds and HSBC Funds

Anne M. Goggin

Pax World Funds

George J. Gorman

Eaton Vance Funds

Keith F. Hartstein

Prudential Retail Funds

Cynthia Hostetler

Invesco Funds

Marie L. Knowles*

Fidelity Fixed Income and Asset Allocation Funds

Thomas P. Lemke

JP Morgan Exchange-Traded Fund Trust and SEI Funds

Joseph Mauriello

Fidelity Equity and High Income Funds

Joanne Pace

OppenheimerFunds

Steven J. Paggioli*

AMG Funds and Professionally Managed Portfolios

Sheryl K. Pressler

Voya Funds

Erik R. Sirri*

Natixis Funds, Loomis Sayles Funds, and Natixis ETFs

Laura T. Starks*

TIAA-CREF Funds

Terence J. Toth

Nuveen Funds

Ronald E. Toupin Jr.

Guggenheim Funds

** On the ICI Board of Governors*

Note: All members of the Governing Council are independent directors at the fund group(s) listed under their names.

IDC Staff



AMY B. R. LANCELOTTA

Managing Director

Amy B. R. Lancellotta has been IDC's managing director since 2006. For 17 years before taking this position, she worked in ICI's Law Department, serving most recently as senior counsel. Before joining ICI, Amy worked in private practice, focusing on issues relating to investment companies and variable insurance products. She is a graduate of the Pennsylvania State University and the George Washington University National Law Center.



ANNETTE CAPRETTA

Deputy Managing Director

Annette Capretta joined IDC in 2006 from the Securities and Exchange Commission, where she served in various capacities in the Office of Risk Assessment, the Division of Investment Management, and the Division of Enforcement. Annette also previously served as vice president and senior counsel at Charles Schwab. She is a graduate of the University of North Carolina and the University of Virginia School of Law.



LISA CHAIKIN HAMMAN

Senior Associate Counsel

Before joining IDC in 2004, Lisa Chaikin Hamman worked at Morgan, Lewis & Bockius LLP, counseling investment advisers and investment companies, and their boards of directors or trustees, on federal regulatory matters. Lisa began her fund industry career in the legal department at Fidelity Investments. She is a graduate of the University of Michigan and Suffolk University Law School.

2017 Activities

Orientation Program Sessions: *Foundations for Fund Directors*

Boston SEPTEMBER

Comment Letters

Modernizing Fund Directors' Responsibilities (SEC Division of Investment Management) OCTOBER

Webinars

Diving In—Understanding the SEC's New Liquidity Rule FEBRUARY

Emerging Financial Technologies: An Overview for Fund Directors MARCH

Board Oversight of Fair Valuation: Current Practices and Themes MAY

Fund Industry Litigation, SEC Enforcement Activity, and Director Indemnification and Insurance JUNE

Fair Valuation (Part 2): A Deeper Dive JULY

MiFID II Investment Research Requirements: An Overview for Fund Directors OCTOBER

Board Oversight of ETFs DECEMBER

Industry Segment Conference Calls

Directors of Small Fund Complexes JANUARY, JUNE

Governance Committee Chairs JANUARY, MAY

Audit Committee Chairs JANUARY, MAY

Board Leaders JANUARY, MAY

Conferences

Fund Directors Workshop MAY

Fund Directors Conference OCTOBER

Chapter Meetings

San Francisco FEBRUARY, DECEMBER

Los Angeles FEBRUARY, DECEMBER

Naples FEBRUARY

Denver MARCH

Washington, DC MARCH

Texas and Arizona (by conference call) MARCH

Philadelphia APRIL, SEPTEMBER

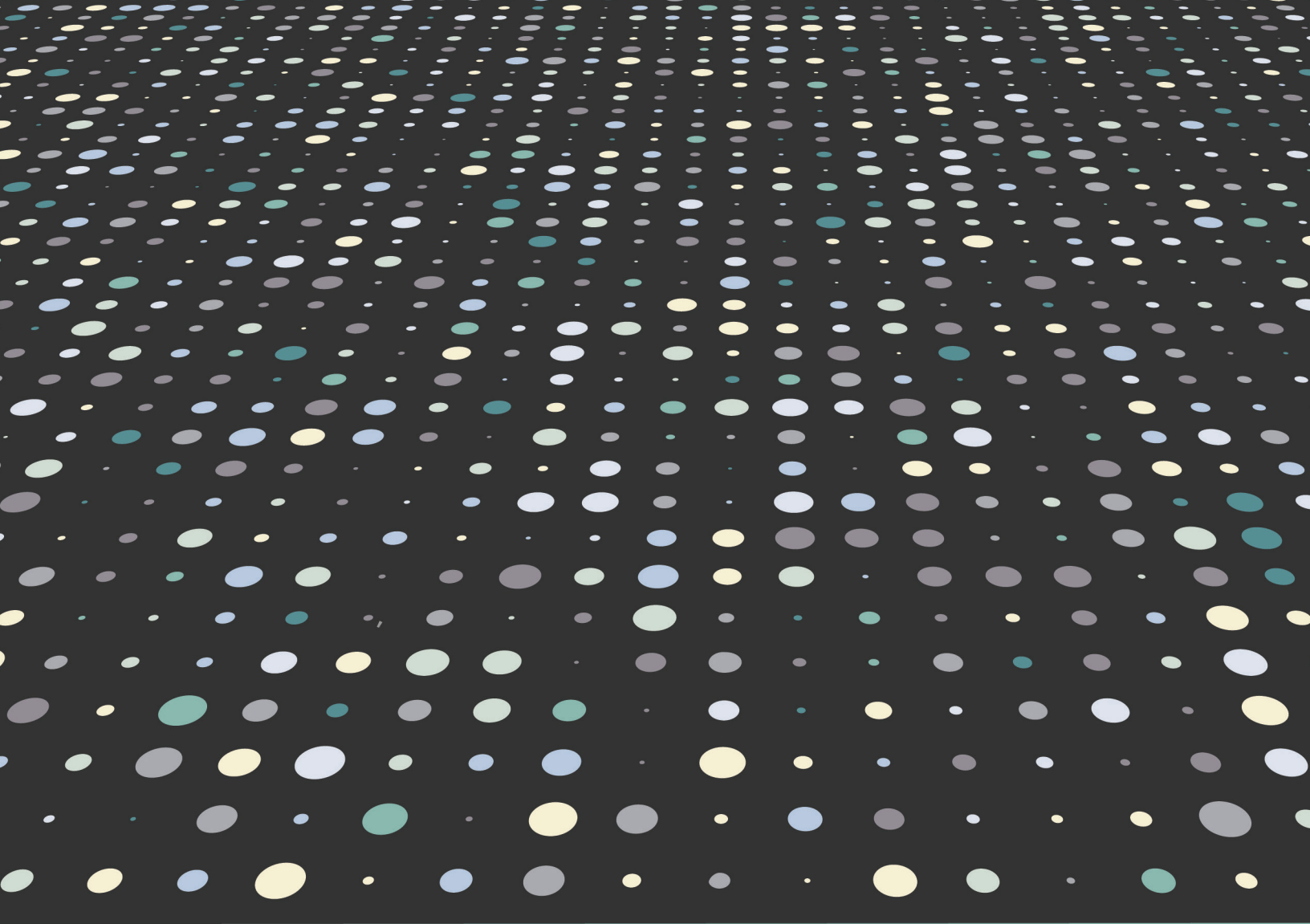
Chicago APRIL

New York APRIL, SEPTEMBER

Boston MAY, OCTOBER

Charlotte JUNE





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